1-1-2005

Digest of state issues 2005, vol. 16, no. 1

American Institute of Certified Public Accountants. State Societies & Regulatory Affairs

Digest of State Issues

AICPA

American Institute of Certified Public Accountants

State Societies & Regulatory Affairs
Volume 16, Number 1 - 2005

American Institute of Certified Public Accountants
State Societies & Regulatory Affairs
1455 Pennsylvania Avenue, N.W.
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AICPA
DIGEST OF STATE ISSUES

ISSUES

UAA **Indicates core provisions contained within the AICPA/NASBA Uniform Accountancy Act (UAA)**

Boldface type in the text indicates significant changes or new material since the last *Digest* issue.

INTRODUCTION

The staff of the AICPA State Societies & Regulatory Affairs Team is responsible for monitoring and tracking key state legislative and regulatory issues that may potentially impact the profession. Through these activities the team is able to detect trends that may be developing within the states and to provide the state CPA societies a forewarning of such issues. The *Digest of State Issues* is partly the product of this trend monitoring system.

The *Digest of State Issues* is updated periodically and is intended as an educational tool in helping state societies and committee members understand the significance of these important issues.

We hope that you will find the *Digest of State Issues* useful in your state activities. We encourage you to distribute this publication freely. In addition to the *Digest*, the State Societies & Regulatory Affairs Team also produces the following publications: *AICPA/NASBA Digest of State Accountancy Laws and State Board Regulations and the AICPA/NASBA Uniform Accountancy Act.*

Additionally, information on many of the issues contained in this publication is available through the AICPA's web site, *AICPA Online,* at www.aicpa.org.

If we can be of assistance or if you have any comments or questions, please feel free to contact anyone in State Societies & Regulatory Affairs. We can be reached at the AICPA Washington office; Sheri Bango - 202/434-9201 and Larry LeClair - 202/434-9261. Also, additional resources on several issues are available from the AICPA's General Counsel Team. For more information, contact Virgil Webb, Assistant General Counsel - 202/434-9222.

APPRAISAL AND BUSINESS VALUATION REGULATION

ISSUE: Whether or not certified public accountants who offer or provide business valuations and/or personal property appraisal services should be licensed or certified.

BACKGROUND: After numerous failures of savings and loan institutions, Congressional reviews pointed to faulty real estate appraisals as contributory factors. As a result, the Financial Institutions Reform, Recovery, and Enforcement Act (FIRREA) was passed by Congress in 1989. The legislation requires states to adopt regulatory mechanisms for real estate appraisers involved with federally related real estate transactions. Such laws were required to be in effect by July of 1992. However, Congress extended the deadline for compliance to December 31, 1992. Also, as part of that same legislation, Congress provided that the Appraisal Subcommittee of the Federal Financial Institutions Examination Council (FFIEC) cannot set licensing and certification standards for states. Further, the bill made clear that recommendations from the appraisal subcommittee of FFIEC are not binding to states.

WHY IT'S IMPORTANT TO CPAs: As states adopted legislation to come into compliance with Federal legislation, several issues outlined below were raised.

1) Reciprocity. Whether or not the legislation being adopted will provide for reciprocity for individuals who provide real estate appraisal services to their clients in other states. It will be difficult for CPAs to practice in multiple states if the state legislation dictates conflicting requirements.

2) Dual Licensure. Individuals should not be required to obtain a real estate broker license in order to be certified as a real estate appraiser. The additional burden and cost of multiple regulation would be counterproductive to those professionals already practicing as real estate appraisers. If a CPA were to be regulated by multiple boards, the chance of a conflict arising over differing standards and requirements would be increased.

3) Business/Personal Property Valuations. The Federal Financial Institution Examination Council Appraisal Subcommittee, to which the AICPA submitted comments, issued a study on the regulation of personal property appraisals under the Act. The subcommittee's report concludes that it is not desirable to regulate personal property appraisals. However, many states adopted real estate appraisal laws that define real estate appraisal practice more broadly. If licensing or certification were required for business valuations or personal property appraisals, CPAs could be affected. In addition to the dual licensure, licensing CPAs as real estate appraisers will require additional examination, experience and continuing education requirements. In some states, there have been problems because CPAs have been told they will be required to have a license or certificate and at the same time have been informed that their experience will not qualify them for licensure.

AICPA POSITION: The AICPA strongly believes that additional government regulation of CPAs who perform business valuations is unnecessary. There is no documented need for regulation of such individuals. In addition, and perhaps most important, this type of measure will not provide any increased protection or benefit to the public, which the law is intended to serve. Legislation containing exemption language has been passed in several states to exclude from licensing those CPAs who perform appraisals of real estate incidental to the performance of professional services they provide to clients.

STATE Most states have passed or amended laws to comply with the Federal regulations. In

ACTION:	some of these states it is unclear whether the regulations would apply to individuals who perform business valuations, and therefore affect CPAs who provide such services. A majority of the legislation relates to the appraisal of real estate. Eight states (Colorado, Idaho, Massachusetts, Oklahoma, Oregon, Pennsylvania, Utah and Washington) have exempted CPAs from this type of regulation.
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CENTRALIZATION OF STATE BOARDS OF ACCOUNTANCY

ISSUE: Whether or not the State Board of Accountancy should be independent or part of an omnibus state licensing board.

BACKGROUND: In the name of economic efficiency, many states are consolidating state government and centralizing state administrative agencies. Under a decentralized structure, most independent boards and agencies access and control their own funds. However, under most consolidation laws these funds revert to the general state fund. Since boards of accountancy are among agencies affected by most consolidation trends, CPAs have become increasingly aware of the implications for the accounting profession. Consolidation can reduce the independence, effectiveness and expertise of the licensing or regulatory body.

WHY IT'S IMPORTANT TO CPAs: There are several reasons why this trend is a threat to the regulation of the profession, as well as poor public policy.

1) Need for Professional Experts. It is important that professional expertise be applied to regulatory and disciplinary decisions. Likewise, peer review of professional practice standards needs to be maintained.

2) Administrative Efficiency. While centralization is generally proposed for economic efficiency, it often produces a larger bureaucracy and an ineffective licensing board.

3) Insulation from Political Interference. An autonomous board structure can be better insulated from political pressure and influence than a central agency. Autonomous boards are controlled by a dual checks and balances system - the legislature and the governor - while a centralized system is generally just accountable to the governor.

AICPA POSITION: The AICPA opposes centralization of state boards of accountancy because of the serious threat to effective regulation of the profession. Centralization can endanger a board's ability to administer and oversee such critical functions as certification, licensing, enforcement and investigation.

STATE ACTION: Several states have implemented a consolidated government structure, and proposals continue to be introduced across the country.

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UAA COMMISSIONS AND CONTINGENT FEES

ISSUE: Under what condition should CPAs be allowed to accept commissions and contingent fees?

BACKGROUND: Historically, CPAs were not allowed to accept commissions and contingent fees. However, when the Federal Trade Commission (FTC) initiated a non-public investigation focusing on the AICPA's commission and contingent fee rules, it concluded that the Institute's rules violated Section 5 of the FTC Act. To end the investigation, AICPA signed a Final Order with the FTC in 1990 narrowing AICPA's ability to prohibit the acceptance of commissions and contingent fees. The AICPA rules, issued after the FTC Order became effective, prohibit the acceptance of commissions and contingent fees only with respect to clients for whom the AICPA member performs attest (as specifically defined in the Order) services. The AICPA rule also prohibits members from preparing original or amended tax returns or claims for tax refunds for a contingent fee.

At the same time of entering into the FTC agreement, which only impacted the AICPA membership requirements, the AICPA governing Council endorsed a resolution to encourage states to seek legislation to prohibit the acceptance or payment of any commission by those in the practice of public accountancy.

More recently the trend has been for states to allow CPAs to accept commissions and contingent fees. During 1997, the AICPA/NASBA Joint Committee on Regulation of the Profession recommended in its Final Report that the position on fee acceptance be modified to enable CPAs to accept commissions with full disclosure, except in situations where the CPA performs attest services for a client. CPAs could accept contingent fees for services, except from clients for whom they perform attest services and for preparing an original tax return. Contingent fees for preparation of amended tax returns or refund claims would be permitted, as long as the CPA had a reasonable expectation the claim would be the subject of a substantive review by the taxing authority. In May 1997, the AICPA governing Council voted overwhelmingly to adopt all of the recommendations of the AICPA/NASBA Joint Committee on Regulation of the Profession, thereby eliminating the AICPA position on restrictions that had previously existed on fee arrangements.

WHY IT'S IMPORTANT TO CPAs: The public's image of the accounting profession is affected most by the quality of the services it receives, not by the fee arrangement for those services. As long as fee arrangements are disclosed, the public is free to choose the type of arrangement it wants. In the eyes of many, prohibitions against such fee arrangements are viewed as self-serving, anti-competitive and not in the public's interest. In some cases, clients are not able to pay for services on an hourly basis, and actually prefer a contingent fee basis. In a free market system, the marketplace should dictate fee arrangements as long as they are disclosed to clients, unless there is an overriding public interest, which is the case for attest services.

AICPA POSITION: A provision permitting the acceptance of commissions and contingent fees, as outlined above, is now included in the *Uniform Accountancy Act* as Sections 14(n-o). The language is taken from the AICPA's Code of Professional Conduct.
Forty-six jurisdictions currently provide for the acceptance of commissions and/or contingent fees.

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CONTINUING PROFESSIONAL EDUCATION (CPE)

ISSUE: Whether those who obtain a CPA certificate should be required to participate in continuing professional education in order to maintain a license or certificate.

BACKGROUND: In order to assure continuing professional competence, nearly all states require licensees to complete continuing education.

WHY IT'S IMPORTANT TO CPAs: The purpose of the continuing professional education requirement is to increase the professional competence of each member of the profession. The environment within which the accounting professional functions is more demanding than ever before. Increasing specialization, a proliferation of regulations and the complex nature of business transactions require a renewed emphasis on continuing maintenance of competence. It is essential that CPAs maintain their professional knowledge by participating in CPE required by their states.

AICPA POSITION: The AICPA supports the position that all CPAs should be required to accomplish CPE within a given time frame. The Institute also encourages flexibility in acknowledgment by state boards of accountancy of the equal importance of courses to compensate for specialization in the profession.

OTHER ACTION: In January 2002, the Joint AICPA/NASBA Statement on Standards for Continuing Professional Education Programs released new CPE standards focusing on proficiency skills.

To comply with the standards, CPAs should: (1) participate in learning activities that maintain or improve their professional competence; (2) comply with all applicable CPE standards, rules and regulations of state licensing bodies, other governmental entities, membership associations, and other professional organizations or bodies; (3) claim the recommended CPE credit only for CPE programs that comply with the standards; and (4) accurately report the appropriate number of CPE credits earned, and maintain documentation of their participation in learning activities giving rise to those credits.

The new standards, which took effect Jan. 1, 2002, also introduce the concept of independent study learning, allowing a CPA to engage in a program of learning with a qualified sponsor on a one-on-one basis. These concepts have been included in the Uniform Accountancy Act as Appendix B.

STATE ACTION: Requirements for CPE vary from state to state. For more information on a particular jurisdiction, consult the *AICPA/NASBA Digest of State Accountancy Laws and State Board Regulations*. Many states made positive changes in their statutes to reflect UAA-related CPE requirements.

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CPA EXAMINATION

ISSUE:

Whether or not the Uniform CPA Examination should continue to be the only examination administered for candidates seeking initial licensure as a CPA.

BACKGROUND:

Examinations to test the qualifications of public accountants were first used in New York state in 1896. As the country and profession grew, more states enacted accountancy laws that required individuals to pass an examination to qualify as a CPA. The AICPA has offered the Uniform CPA Examination as a tool for licensing CPAs since 1917. By the 1960s all jurisdictions required new CPAs to have passed the Uniform CPA Examination prepared by the AICPA and graded by its Advisory Grading Service.

The current Uniform CPA Examination is delivered to candidates through agreements between the state boards of accountancy and the accounting profession, represented by the AICPA. The Uniform CPA Examination is regarded as one of the premiere licensing examinations in the United States.

Recently, forces in the marketplace are changing the demands for CPAs and the skills required for becoming a CPA. In order for the licensing exam to continue to adequately protect the public, it must assess these skills. It was primarily for this reason that a joint group from AICPA and NASBA was put together to implement a computer-based examination that will test both technical knowledge and "real-world" skills that are essential for CPAs to practice competently. The first computer-based exam was offered in April 2004.

WHY IT'S IMPORTANT TO CPAs:

Reciprocity and interstate mobility for CPAs is one of the most important issues for the profession. The Uniform CPA Examination is the one and only common element for certification and licensure used by all states. Lack of uniformity is one of the major barriers to reciprocity and mobility.

AICPA POSITION:

The AICPA is committed to the future of the CPA examination and has recently invested substantial resources to ensure the reliability and validity of the exam. In addition, through the UAA, the practice of one uniform examination for the entire profession was reaffirmed through the concept of substantial equivalency (UAA Section 23), which contains basic criteria for initial licensure as a CPA, including 1) 150 semester hours of education, including a baccalaureate degree, 2) successfully passing the uniform CPA examination, and 3) a one year general experience requirement verified by a licensee, which is broadly defined to accommodate experience in all fields of employment (i.e., public accounting, industry, education, government, etc.).

STATE ACTION:

In order to ensure that states were prepared to administer a computer-based examination by 2004, state statutes and regulations were amended and *The Uniform Accountancy Act and Uniform Accountancy Act Rules, Third Edition Revised* incorporated model language to provide guidance for states.

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UAA CPA = CPA

ISSUE:

Regardless of where CPAs are employed, they should be able to use their title, in conjunction with their business activity, as long as they meet certain licensing criteria, meet continuing professional education (CPE) standards, and are subject to regulation by a state board of accountancy.

BACKGROUND:

The concept of "CPA=CPA" was created in the Final Report of the AICPA/NASBA Joint Committee on Regulation of the Profession. In the report, the Joint Committee recommended that all CPAs, regardless of their particular field or place of employment, be subject to licensure and regulation by the state board of accountancy.

Provisions in the *Uniform Accountancy Act* (UAA) accomplish this concept by requiring all individuals who wish to use the CPA title to hold a valid license. Individuals may obtain a CPA license once they demonstrate they have met appropriate education, examination and experience requirements. The license must be renewed by demonstrating compliance with a CPE requirement.

WHY IT'S IMPORTANT TO CPAs:

Recent court decisions have ruled that duly licensed CPAs may use their "CPA" designation while working in non-CPA firms. As a result, the definitions of "holding out" and "practice of public accountancy" have been removed from the UAA. Now, under the framework of the UAA, regardless of where CPAs are employed or what they do, all licensed CPAs are subject to regulation by the state board.

AICPA POSITION:

As long as individuals hold a CPA license they are subject to the authority of the state board of accountancy, regardless of what they do for a living and regardless of whether they use their CPA title. All licensees must comply with the accountancy law and regulations.

To be consistent with the broad regulatory approach envisioned under this concept, the initial experience requirement in the UAA has changed. The "public accounting" experience requirement, contained in previous editions of the UAA, was restrictive and did not reflect today's environment for CPA services. The UAA contains a broad experience requirement for initial licensure of one year of providing any type of professional service or advice involving the use of accounting, attest, management advisory, financial advisory, tax or consulting skills. As part of the application process for licensure, a licensed CPA must verify this experience. This experience (professional service or advice) can be gained through employment in government, industry, academia or public practice.

Likewise, to reflect the equality of this new regulatory framework, all licensees as a provision for re-licensure must complete CPE.

STATE ACTION:

As states adopt the core provisions of the UAA, they are incorporating the concept of CPA=CPA by moving from a two-tier regulatory structure to a one-tier structure and requiring CPE for all licensees.

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UAA EXPERIENCE REQUIREMENT

ISSUE:

What type of experience requirement is necessary for licensure into the profession?

BACKGROUND:

The amount and type of licensure experience varies greatly from state to state. The current state requirements range from no experience to more than two years, with very specific accounting and auditing hour provisions. It is often difficult for licensees to obtain reciprocity in other jurisdictions due to the diverse requirements.

WHY IT'S IMPORTANT TO CPAs:

Reciprocity and interstate mobility for CPAs are important issues that become even more critical in a global economy. Individual CPAs who practice across state lines, or who serve clients in other states via electronic technology, need to meet the regulations in the states in which they practice. This becomes difficult when the requirements vary so greatly from state to state.

AICPA POSITION:

Experience for Licensure:

With NASBA, the AICPA supports a one-year broad-based experience requirement for initial licensure. This requirement has been incorporated into the UAA and is included within the concept of substantial equivalency (UAA- Section 23). The concept contains basic criteria for initial licensure as a CPA, including 1) 150 semester hours of education, including a baccalaureate degree, 2) successfully passing the Uniform CPA Examination, and 3) a one year general experience requirement verified by a licensee, which is broadly defined to accommodate experience in all fields of employment (i.e., public accounting, industry, education, government, etc.).

The "public accounting" experience requirement, contained in previous editions of the UAA, was restrictive and did not reflect today's environment for CPA services. This three-pronged approach to licensure assures that newly licensed CPAs are well educated and able to accommodate an expanding global economy.

Competency Requirement for Attest and Compilation Services:

While the UAA moves to a broader experience requirement for initial licensure, it also adds a provision requiring additional specific experience for appropriate individuals in firms that perform traditional attest and compilation services. This section, UAA 7(c)(3)-(4), is designed to provide protection to the public with respect to the most sensitive services provided by licensees – attest and compilation services. Any licensee who is responsible for supervising traditional attest and compilation services and who signs or authorizes someone to sign the accountant's report on the financial statements on behalf of the firm must comply with the appropriate competency requirement for such services as dictated by the *Statement on Quality Control Standards; the Personnel Management Element of a Firm's System of Quality Control – Competencies Required by a Practitioner–in- Charge of an Attest Engagement.*

STATE ACTION:

Twenty-two states have enacted proposals supporting the one-year general experience requirement for initial licensure; moreover, numerous states are seeking to enact the one-year experience for licensure and competency requirements for attest and compilation services.

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FINANCIAL PLANNER/INVESTMENT ADVISER REGULATION

ISSUE: Should CPAs who offer financial planning services be subject to licensing and regulation under state investment adviser and securities laws?

BACKGROUND: The term "financial planner" is an imprecise term, which has no accepted definition in federal securities laws, nor in most state securities statutes. Financial planning includes a broad range of services, and those who hold themselves out to the public as financial planners include representatives from diverse professions. CPAs have traditionally offered financial planning services as a part of their accounting practice. CPAs who offer these services are subject to regulation by state boards of accountancy, as they are for other professional services they perform. The majority of states regulate investment advisers under state securities laws. Most of the states have adopted the Investment Adviser provisions of the Uniform Securities Act of 1956. In addition, those who act as investment advisers are subject to the provisions of other federal securities laws – Securities Act of 1933, Securities Exchange Act of 1934, and the Investment Advisers Act of 1940. The Act of 1940 excludes CPAs, among other professionals, from the definition of investment advisor and those professionals who provide investment advice solely incidental of their profession. Future congressional activity may put this exclusion in jeopardy.

WHY IT'S IMPORTANT TO CPAs: Licensed CPAs are subject to regulation by their respective state boards of accountancy and strict professional ethics rules adopted by the boards to protect the public against fraud, incompetence and conflict of interest. CPAs should not be required to subject themselves to regulation by securities departments merely because they hold themselves out as financial planners.

AICPA POSITION: The AICPA objects to amending state investment adviser statutes to include a "holding out" provision requiring persons using the financial planner title to register or redefine the term investment adviser to include financial planners. The Institute does, however, support the state licensing or registration of CPA financial planners who perform those investment-related services that have the highest potential to injure their clients. Those services are: holding client funds with investment discretion, being compensated by commissions from the purchase or sale of investments and advising on the purchase or sale of specific investments unless that advice is related to financial statement analysis or tax considerations.

STATE ACTION: Forty-seven states and the District of Columbia currently regulate investment advisers. Eight of those jurisdictions include the term "financial planner" within the definition of investment adviser (using the North American Securities Administrators Association model amendments) and another two of those states use this definition, as well as the holding out provision supported by the Financial Planning Association.

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FORM OF PRACTICE
INCLUDING:

GENERAL CORPORATE FORM (GC), LIMITED LIABILITY COMPANIES (LLC), REGISTERED LIMITED LIABILITY PARTNERSHIPS (LLP) AND AMENDMENTS TO PROFESSIONAL CORPORATION (PC) LAWS

ISSUE: Whether states should allow CPAs to organize in legal forms other than proprietorships, partnerships and PCs and whether states should amend PC laws in order to make PCs more attractive to a larger number of CPA firms.

BACKGROUND: Because of the 1992 AICPA membership vote to change Rule 505, which allows members to practice under any legal form of organization, states have worked to enact legislation to create LLCs, LLPs and to allow CPAs to practice in general corporations. The purpose of the rule change was to allow for the creation of more organizational options for CPA firms, because practice in general corporate form or as an LLC or LLP may provide advantages to practitioners. A nation-wide effort to draft LLC legislation was spearheaded by the American Bar Association. It has been suggested that due to their tax benefits and operational flexibility, LLCs are likely to become a major economic development vehicle.

WHY IT'S IMPORTANT TO CPAs: LLCs and general corporations may provide benefits in terms of increased protection from tort and contract claims and LLCs may also limit tax liability. Registered limited liability partnerships (LLPs) may limit liability of innocent partners for acts and omissions of other partners. In general, the members of an LLC are not personally liable for the debts of the LLC, and a state's LLC law may provide more liability protection than the state PC law. In addition, the IRS has ruled that LLCs may be treated as partnerships for federal income tax purposes. Important considerations in drafting LLC legislation include: 1) that the proposal authorize professionals to use LLCs; 2) that the bill limit liability of LLC members, managers, employees and agents; 3) that it provide for organizational flexibility for professional LLCs; and 4) that it include provisions that adequately allow for interstate practice for professional LLCs.

Before CPA firms may operate as LLCs, LLPs or general corporations, it may be necessary to amend the state accountancy law and the state's accountancy regulations. In addition, many state PC laws contain provisions that limit their utility for CPAs, especially multi-state firms.

AICPA POSITION: Since the 1992 membership vote that changed Rule 505, the Institute has strongly supported the efforts of state societies to work for passage of LLC and LLP legislation and to allow CPAs to form general corporations. In addition, the AICPA encourages states to modify accountancy statutes and regulations to allow practitioners to take advantage of the Rule 505 change.

STATE ACTION: Fifty-one jurisdictions have passed LLC legislation. In addition, fifty-three jurisdictions have passed LLP legislation. At least two states have passed bills to allow CPAs to form general corporations. In addition, forty-three states have amended their accountancy statute to provide for these forms of practice.

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INSURANCE COMPANY AUDITS

ISSUE: How the profession should respond to legislation that requires insurers to have annual audited statutory financial reports of insurance companies.

BACKGROUND: All states require domiciled insurance enterprises to submit to the state insurance commissioner an annual statement on forms developed by the National Association of Insurance Commissioners (NAIC). The states also require that audited statutory financial statements be provided as a supplement to the annual statements.

The insurance laws and regulations of most states require insurance companies domiciled in those states to comply with the guidance provided in the NAIC *Accounting Practices and Procedures Manual* except as prescribed or permitted by state law. In 1999, the NAIC completed a process to codify statutory accounting practices for certain insurance enterprises, resulting in a revised Accounting Practices and Procedures Manual effective January 1, 2001 (the "revised Manual").

Prescribed statutory accounting practices are those practices that are incorporated directly or by reference in state laws, regulations, and general administrative rules applicable to all insurance enterprises domiciled in a particular state. States may adopt the revised Manual in whole, or in part, as an element of prescribed statutory accounting practices in these states. Auditors of insurance enterprises should review state laws, regulations, and administrative rules to determine the specific prescribed statutory accounting practices applicable in each state.

WHY IT'S IMPORTANT TO CPAs: The revised Manual and annual instruction statement requires insurers to engage an independent CPA to prepare specific reports and letters and, in certain instances, to report to state insurance commissioners, to make available and maintain working papers, and to conduct audits in accordance with statutory auditing standards.

AICPA POSITION: The AICPA supports the revised Manual as developed by the NAIC.

STATE ACTION: It is expected that most states will require insurers to comply with the revised Manual. It may be necessary for some states to take legislative or regulatory action to adopt the revised Manual, while other states will not require legislative action to change the rules for this new compliance.

OTHER ACTION: The AICPA's Accounting Standards Executive Committee issued Statement of Position (SOP), *Amendments to Specific AICPA Pronouncements for Changes Related to the NAIC Codification.* The SOP amends AICPA SOP 94-5, *Disclosures of Certain Matters in the Financial Statements of Insurance Enterprises,* as a result of the completion of the National Association of Insurance Commissioners (NAIC) Codification of statutory accounting practices for certain insurance enterprises.

The amendments to SOP 94-5 included in this SOP require insurance enterprises to disclose, at the date each balance sheet is presented, beginning with financial statements for fiscal years ending on or after December 15, 2001, a description of the prescribed or permitted statutory accounting practice and the related monetary effect on statutory surplus of using an accounting practice that differs from either state prescribed statutory accounting practices or NAIC statutory accounting practices. Retroactive application is not permitted.

This SOP also includes the following auditing guidance that has been updated as a result of the completion of the NAIC Codification: AICPA SOP 95-5, *Auditor's Reporting on Statutory Financial Statements of Insurance Enterprises;* SOP 94-1, *Inquiries of State Insurance Regulators*; and AICPA Auditing Interpretation No. 12, "Evaluation of the Appropriateness of Informative Disclosures in Insurance Enterprises' Financial Statements Prepared on a Statutory Basis," of Statement on Auditing Standards (SAS) 62, *Special Reports* (AICPA, *Professional Standards,* vol. 1, AU sec. 9623.60–.77). The included auditing guidance has been approved by the Auditing Standards Board.

This SOP was effective for annual financial statements for fiscal years ending on or after December 15, 2001, and complete sets of interim financial statements for periods beginning on or after that date and audits of those financial statements. If comparative financial statements are presented for fiscal years ending before December 15, 2001, the disclosure provisions of SOP 94-5 effective prior to this SOP apply to permitted statutory accounting practices by the regulatory authority.

During the spring of 2004, the NAIC proposed revisions to the Model Audit Rule (MAR) with regards to the Sarbanes-Oxley Act. The AICPA submitted a comment letter to NAIC on behalf of the profession. The NAIC is still in the process of deliberating the proposed revisions, and has formed a subgroup of interested parties to further discuss the effects of any proposed revisions. Auditors of insurance enterprises should monitor any changes to the MAR.

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NEW CLASS OF LICENSED ACCOUNTANT

ISSUE:	Whether or not states should recognize a class of licensed accountants in addition to certified public accountants.
BACKGROUND:	Several states recognize a class of licensed accountant in addition to CPAs. In some states these are a continuing class. In others, accountants who were registered before a given date are allowed to maintain their status.
WHY IT'S IMPORTANT TO CPAs:	Over the years, legislation has been enacted in the states to increase standards of the accounting profession to better serve the public. These increased standards for CPAs generally include a specified minimum amount of education, a requirement for passing the uniform CPA examination and, once licensed, participation in continuing professional education (CPE) to maintain that license. It is not in the public interest to permit persons who have not demonstrated the level of professional competence prescribed for licensure and who do not comply with these minimum standards to practice public accountancy.
AICPA POSITION:	The AICPA is strongly opposed to state laws that would allow a person who is not a CPA to perform public accounting services traditionally associated with CPAs, including the audit function.
STATE ACTION:	Currently, ten states recognize a multi-class licensing system. The remaining states maintain a one-class system, which may include a dying or grandfathered class. Although there is limited activity expected in this area, the issue is important and will continue to be monitored.
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UAA 150-HOUR EDUCATION REQUIREMENT

ISSUE: Should the education requirement for CPAs be increased to 150 semester hours of education, which includes a baccalaureate degree?

BACKGROUND: To become a certified public accountant, many states still require a baccalaureate degree. A proposal promoted by AICPA would increase the minimum education requirement to become a CPA to include 150 semester hours of education, a baccalaureate degree and accounting concentration. Since the inception of the proposal, a majority of states have enacted the 150-hours of minimum education, becoming effective at a future date.

WHY IT'S IMPORTANT TO CPAs: With the business environment becoming increasingly complicated, certified public Accountants must meet new challenges when making critical business decisions. Prospective CPAs need to have a broad educational base that includes accounting and business knowledge and develops the skills needed for continued growth in a fast changing global economy. There are a number of reasons that an increase in the education requirement is needed:

1) Improved Quality of Work. A more educated group of graduates will produce a more educated group of accountants. The public will be able to continue to place its trust in the work performed by CPAs if the public knows the skills that have been obtained are the result of a comprehensive education.

2) Increased Technical Competence. The greater demands of business, as well as the continuing expansion of practice in an international environment, have further enhanced the need for highly technical accounting services.

3) A Complete Education. To function effectively, CPAs must have more than technical knowledge of their profession. They must also be educated in history, languages and the sciences. Studies have shown that accountants with education beyond the normal 120-hour baccalaureate degree have a performance level that is superior to those who have only 120 hours of education.

AICPA POSITION: The AICPA has recognized the value of the 150-hour education requirement since 1959. In a 1988 vote, the membership agreed overwhelmingly to amend the by-laws of the Institute to require 150-hours of education for new members after the year 2000.

Recently, the position on the 150-hour requirement was reaffirmed through the new concept of substantial equivalency, which was incorporated into the *Uniform Accountancy Act* as Section 23, and contains basic criteria for initial licensure as a CPA, including: 1) 150 semester hours of education, including a baccalaureate degree; 2) Successfully passing the uniform CPA examination, and 3) a one year general experience requirement verified by a licensee, which is broadly defined to accommodate experience in all fields of employment (i.e., public accounting, industry, education, government, etc.).

STATE ACTION: Forty-eight jurisdictions have enacted legislation and/or regulations that would provide for the 150-hour requirement. Currently, forty-five states have the 150-hour requirement in effect.

OTHER ACTION:

In addition to the AICPA, the National Association of State Boards of Accountancy (NASBA), the American Accounting Association (AAA) and the Federation of Schools of Accountancy (FSA) all support the 150-hour education requirement.

In an effort to determine how changes in business and the profession are impacting accounting education, the AICPA collaborated with the American Accounting Association (AAA), Institute of Management Accountants (IMA) and the Big Five firms to initiate a project that resulted in a study "Accounting Education: Charting the Course Through a Perilous Future." Another research study conducted concurrently by the Taylor Group, "Student and Academic Research Study," showed that students expect to continue their education to obtain an advanced degree and that the requirements to become a CPA are not a barrier to licensure.

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UAA OWNERSHIP OF CPA FIRMS

ISSUE: Whether non-CPAs should be permitted to have ownership interests in CPA firms.

BACKGROUND: Rule 505 of the AICPA Code of Professional Conduct allows AICPA members to practice in forms of organization permitted by state law whose characteristics conform to resolutions of AICPA Council. In May 1994, Council approved a resolution allowing firms to include non-CPA owners. The AICPA/NASBA Joint Committee on Regulation of the Profession reviewed this issue and in its final report recommended that all entities that wish to call themselves CPA firms or use the designation CPAs in conjunction with their entity name must be owned by a simple majority of CPAs. The AICPA Council adopted the report in May 1997. This language was included in the *Uniform Accountancy Act* (UAA) as Section 7(c).

WHY IT'S IMPORTANT TO CPAs: There are legitimate professional reasons for CPA firms to have non-CPA owners. For instance, individuals are needed to perform related professional services and provide specialized expertise on complex audits. Firms have had non-CPA owners for decades without any demonstrated harm to the public. Also, some firms have created additional subsidiaries to accommodate the involvement of non-CPAs. In this case, the CPAs and non-CPAs own the business and work together. The CPAs do not use their title in this business, but in most communities it is widely known they are CPAs.

AICPA POSITION: The AICPA supports non-CPA ownership of CPA firms. The UAA section provides that:

- Licensed CPAs must hold a simple majority of the ownership.
- A licensed CPA must be the managing partner/owner of the firm.
- The partner/owner in charge of attest services must be a licensed CPA.
- And, all non-CPA owners must be actively engaged in working for the firm, or an affiliated entity. Passive ownership is not permitted.

Under the UAA provision, unless the firm complies with the ownership requirement, it cannot obtain a license. Only a licensed CPA firm may perform attest services and call itself a CPA firm.

STATE ACTION: Thus far, proposals have been enacted in thirty-six states.

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UAA PEER REVIEW

ISSUE:

Should CPAs be required to undergo periodic review of their accounting and auditing practices?

BACKGROUND:

In 1988, AICPA members approved a bylaw amendment requiring, as a condition of AICPA membership, all AICPA members active in the practice of public accounting to be associated with a firm that is enrolled in an AICPA approved practice-monitoring program. In 1990, the bylaws were amended to require AICPA members to be associated with a member firm of the SEC Practice Section, if the firm audited one or more SEC clients. In 1997, the bylaws were amended requiring all AICPA members active in the practice of public accounting to practice in a firm enrolled in an Institute approved practice-monitoring program if the services performed by such a firm are within the scope of the AICPA's practice-monitoring standards and the firm issues reports purporting to be in accordance with AICPA professional standards. In 2000, the bylaws were amended to require individual CPAs to enroll (not the firm) in an Institute-approved practice-monitoring program if they perform compilation services in firms or organizations not eligible to enroll in such a program.

The Board completed a project of re-evaluating the objectives, administration, performance, reporting, and overall effectiveness of system reviews under the AICPA Standards for Performing and Reporting on Peer Reviews. Revised Standards include, but are not limited to, revisions to the transparency of reporting, enhanced risk based approach for system reviews and timing of engagement selection.

Prior to the Public Company Accounting Oversight Board (PCAOB) assuming responsibility for reviewing audits of publicly held companies and the CPA firms that perform them, the AICPA had an SEC Practice Section Peer Review Program. This has been replaced by the AICPA Center for Public Company Audit Firms (Center) Peer Review Program to assist firms required to be registered with and inspected by the PCAOB in having a peer review of the portion of a firm's accounting and auditing practice applicable to non-SEC issuers. The Center PRP is administered by the AICPA.

WHY IT'S IMPORTANT TO CPAs:

Peer reviews are designed to improve the quality of accounting and auditing services provided by CPAs as well as providing public protection.

AICPA POSITION:

The AICPA promotes the concept of peer review and supports state boards that have enacted programs. The AICPA believes that states should recognize equivalent reviews, such as those performed as part of the AICPA programs, as sufficient to satisfy a state requirement

The AICPA/NASBA *Uniform Accountancy Act* (UAA) contains a peer review section that was modified based on the recommendations of the AICPA/NASBA Joint Committee on Regulation of the Profession. UAA section 7(h) requires that firms performing the attest function undergo a peer review every three years. For more information on this model requirement, consult section 7(h) of the UAA.

The UAA extends peer review to individuals performing compilation services outside of a licensed CPA firm. This requirement conforms to the UAA removing compilations from the definition of "attest services," thereby allowing licensees to perform SSARS compilations outside of a CPA Firm.

For more information on this model requirement, consult section 6(j) of the UAA.

STATE ACTION:

Thirty-seven states have provisions that provide for some form of review program. Several other states have regulations that are broad enough so that the state board of accountancy has the authority to develop such programs. **In 2004 the following states, Arizona, Indiana, Oklahoma and South Carolina passed legislation requiring mandatory peer review for re-licensure.**

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RIGHT TO PRACTICE

ISSUE: In the last 10 years, there has been an increase of proposed rules and advisory opinions promulgated by state bar associations and branches of state government regarding unauthorized practice of law restrictions that impact CPAs.

BACKGROUND: It is widely recognized that an overlap of the accounting and legal professions exists. The areas of tax practice, estate planning and pension planning are so interrelated that it is difficult to distinguish professional jurisdictions. For more than forty years the American Bar Association (ABA) and the AICPA have worked together through the National Conference of Lawyers and Certified Public Accountants to promote understanding between the professions and their clients.

Unfortunately, within the past several years, the subject of unauthorized practice of law has reemerged in several states. Although in some cases CPAs are not the specific targets of these actions, the proposed rules are often drafted so broadly that they would seriously impact the normal practice of CPAs.

WHY IT'S IMPORTANT TO CPAs: As activity by state bar associations increases in the area of unauthorized practice of law, it threatens the ability of CPAs to practice in traditional and customary areas of public accounting.

AICPA POSITION: Through both the State Societies & Regulatory Affairs and the Taxation Teams, the AICPA has worked, and continues to work with, state CPA societies in each of the jurisdictions that requires assistance. In addition, a task force of the AICPA Relations with the Bar Committee was formalized in 1997. This task force will assist state societies in responding to situations as they arise.

State societies are urged to monitor this issue and to determine if the bar associations in their respective states are considering any new proposals dealing with the unauthorized practice of law.

STATE ACTION: South Carolina (1991) – A major decision was rendered when a redefinition of practice of law in the form of proposed rules by the South Carolina Bar Association, to include all tax work except the actual preparation of tax returns was proposed. The South Carolina Association of CPAs, the AICPA and the larger firms filed a brief before the Supreme Court of South Carolina, on behalf of the profession. In September of 1992, the South Carolina Supreme Court issued an Order rejecting the proposed rules submitted by the state bar association. In its order, the court recognized the "unique status" of CPAs and acknowledged respect for the training and procedures under which CPAs operate. The court rejected the proposed rules as "neither practicable or wise" and instead will decide the unauthorized practice of law on a case-by-case basis.

Other action by state bar associations and branches of state government have included the following significant proposed rules and advisory opinions during the last ten years:

District of Columbia (1995 - 1997) - Proposed rules on the unauthorized practice of law were drafted by a D.C. Bar Association committee. Because of the broad definition that was being proposed, it was possible that if this definition were approved, traditional accounting services could be affected. The Greater Washington Society of CPAs (GWSCPA) and the AICPA forwarded comments on the impact of these proposals to the appropriate Bar Committee in 1995. A comment letter on the proposed rules was transmitted to the D.C. Court of Appeals in February 1997.

Alaska (April 1996) - Proposed rules on the unauthorized practice of law are pending before the Alaska Supreme Court. As currently drafted, the rules may impact traditional services provided by CPAs. A comment letter asking the Court to clarify the rules was submitted on behalf of the Alaska Society of CPAs.

New Hampshire (1994) - A State Supreme Court decision, which narrowly defined the practice of law before state agencies, has the potential to impact CPAs representing taxpayers before the New Hampshire Board of Tax and Land Appeals. Comments on whether non-lawyer agents who represent taxpayers before this Board are engaged in the unauthorized practice of law were submitted on behalf of the profession by the New Hampshire Society of CPAs, the AICPA and the larger firms.

Tennessee (1993) - A favorable decision by the Supreme Court of Tennessee was issued in late 1995. The decision resulted from a petition from the state's Attorney General requesting a determination of whether representation of taxpayers by registered appraisers and other non-attorneys before the state and local boards of equalization constitute the practice of law. The Tennessee Society of CPAs, the AICPA and the larger firms filed a brief before the Supreme Court on behalf of the profession.

In 2003, Nebraska, Ohio and Texas had active issues. Some of these actions included legislative attempts to redefine the unauthorized practice of law. The AICPA has worked with the state CPA societies to resolve these issues.

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SALES TAX ON ACCOUNTING SERVICES

ISSUE: As states face financial difficulty, they are increasingly looking to sales and use taxes on professional services as a means of increasing state revenues.

BACKGROUND: In 1987 Florida became the first state in decades to extend a broad-based sales and use tax on services. Although the tax was repealed after six months, other states have aggressively pursued similar legislation. Similarly, a sales tax on consulting services in Iowa was signed into law in April of 1992, and was repealed one month later. The need to maintain an adequate revenue flow and at the same time improve public services has resulted in many state legislatures adding taxes in a piecemeal fashion, without a comprehensive review of the entire tax structure. A study co-sponsored by the National Conference of State Legislators, "Financing State Government in the 1990s," raises serious concerns that state governments experiencing budget shortfalls may attempt to raise revenue trough taxes on professional services. The issue is being readdressed, as many states face severe budget short falls in the early 2000's

WHY IT'S IMPORTANT TO CPAs: There are several reasons why sales and use taxes are not only a bad idea for CPAs, but for all services.

1) <u>Discrimination against small and emerging businesses</u>. Small firms are forced to use outside services. The compliance costs can be very high. Most importantly, siphoning monies into additional taxes limits the growth of small companies.

2) <u>Pyramiding taxes on services and final goods</u>. Under this kind of system, the potential for goods and services being taxed several times exists and this results in higher consumer costs.

3) <u>States with service taxes are at a competitive disadvantage compared to states that do not tax services.</u> Not only does it discourage the use of services, but it discourages companies seeking to relocate or expand.

AICPA POSITION: The AICPA works with state CPA societies to oppose the imposition of a sales tax on services. The AICPA does recognize that revenue raising to support government programs is an ongoing process that constantly requires reassessment of current taxing structures. Because of the administrative and technical difficulties associated with the enactment of a service tax, we believe states should seek other alternatives.

The AICPA's Tax Team can provide a document that states can use that addresses key points to consider when discussing this issue with state legislators.

STATE ACTION: Currently there are five states that impose some form of tax on accounting services. These states are Delaware, Hawaii, Nevada, New Mexico and South Dakota. There has been activity on the state legislative and judicial levels to redefine some traditional services as products, thus making them available to a sales tax. Another trend being noticed is an increased enforcement of tax revenue collection among states. These trends may be linked in part to the increase of economic activity on the Internet and the moratorium on an internet sales tax, therefore, decreasing the states overall sales tax revenue.

Activity occurred in this area as states looked for new alternatives to supplement decreasing tax revenues. **During the first part of the 2005 legislative session,**

Montana and North Dakota introduced legislation.

OTHER ACTION:	AICPA monitors this issue on a nationwide basis. In addition, the AICPA's advocacy document; *Sales and Use Tax on Services: Arguments Opposing Implementation of Such a Tax* is available for use by state societies.
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STATE TAXPAYERS' BILL OF RIGHTS

ISSUE: Establishment of a state Taxpayers' Bill of Rights that would, among other things, establish a taxpayers' advocate within the Department of Taxation to coordinate resolution of taxpayer complaints and problems.

BACKGROUND: In 1988, California became the first state to enact a Taxpayers' Bill of Rights. The legislation provided safeguards for taxpayers in their dealings with state tax agencies and established standards governing the conduct of these agencies. Such a system helps to improve communications between state government and the taxpayer, and enhances the tax collection process overall. This action was followed by similar federal legislation in 1988, when Congress enacted the Omnibus Taxpayer Bill of Rights as part of the Technical and Miscellaneous Revenue Act of 1988. The federal legislation is very similar to legislation that has been enacted in the states. Since then, additional federal laws have been enacted to strengthen taxpayer' rights at the federal level.

WHY IT'S IMPORTANT TO CPAs: The underlying goals behind a taxpayers' bill of rights are to promote a tax system that encourages the voluntary reporting of taxes and to protect the public interest. To a considerable extent, many of the proposals that have been passed have not established new rights for the taxpayer, but have served to codify existing fundamental principles. All of this enhances the work of a certified public accountant and the accounting profession. The issue gives CPAs an opportunity to serve the public by working to affect legislation that promotes the use of fair procedures by state revenue departments.

AICPA POSITION: AICPA supports the concept of a state taxpayers' bill of rights. In 1989 the AICPA State Legislation Committee wrote model language and encouraged state CPA societies to support legislation in their own states. In November 1996, additional information was transmitted to state societies based on provisions from the federal Taxpayer Bill of Rights 2 (H.R. 2337), which became law in July 1996. This law contains a variety of provisions designed to protect taxpayers in their dealings with the Internal Revenue Service (IRS) and provide even greater rights and protections.

STATE ACTION: Thirty-one states have adopted a state taxpayers' bill of rights since 1988. They are: Alabama, Arizona, Arkansas, California, Connecticut, Florida, Georgia, Hawaii, Illinois, Indiana, Iowa, Kansas, Maine, Maryland, Massachusetts, Minnesota, Missouri, Nebraska, Nevada, New Jersey, New York, Ohio, Oregon, South Carolina, South Dakota, Tennessee, Texas, Utah, Virginia, West Virginia and Wyoming.

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UAA SUBSTANTIAL EQUIVALENCY

ISSUE: To promote greater ease of mobility across states lines for CPAs both in person and electronically.

BACKGROUND: Substantial equivalency is a new regulatory concept that will allow CPAs to operate across state borders with greater ease. Under this concept, if a CPA has a valid license from a state with CPA licensing criteria that are "substantially equivalent" to those outlined in the *Uniform Accountancy Act* (UAA), then the CPA can cross state lines to practice in another state without obtaining a license in that state. However, the CPA must notify the state board of his or her intent to practice and agree to follow the law and rules in that state.

Under "substantial equivalency," the license granted by the state of one's "principal place of business" enables an individual CPA to practice across state lines, physically or via electronic technology, without requiring the CPA to obtain a reciprocal license, as long as the original state of licensure is deemed "substantially equivalent." If a CPA moves or relocates his or her principal place of business to another state and establishes a practice or employment there, then he or she must obtain a reciprocal license in that state. However, in this case, the application process would be streamlined if the CPA comes from a "substantially equivalent" state.

WHY IT'S IMPORTANT TO CPAs: Individual CPAs who practice across state lines, or who serve clients in another state via electronic technology, would not be required to obtain an additional reciprocal or temporary license if they hold a valid license from another state deemed substantially equivalent, or if they are individually deemed substantially equivalent. In either case, the CPA must notify the state board in the state where the service will be performed.

In light of the globalization of business and the effect technology has had on the ability of CPAs to serve clients regardless of their physical location, the concept of substantial equivalency is a crucial contribution to the profession and the public it serves.

AICPA POSITION: The AICPA/NASBA Joint Committee on Regulation of the Profession developed the concept of substantial equivalency. In the Committee's Final Report, the provisions for substantial equivalency were outlined, and the language was incorporated in the current edition of the *Uniform Accountancy Act* (UAA) as Section 23. In order for a state to meet the criteria for substantial equivalency, it must meet or exceed the following requirements for initial licensure:

- 150 hours of education
- The Uniform CPA examination
- One year of experience

The AICPA strongly supports the enactment of substantial equivalency in all licensing jurisdictions and stands ready to assist any state in achieving this goal. To that end, the AICPA/NASBA National Steering Committee on Regulation of the Profession was formed in November 1997 to assist state CPA societies and state boards of accountancy in enacting the core provisions of the UAA, including substantial equivalency. The committee is comprised of AICPA and NASBA members and state CPA society and state board of accountancy representatives.

STATE ACTION: Under the concept of "substantial equivalency," not only must the state's initial licensing requirements be equivalent to those in the UAA, but also language providing for this concept must be enacted (UAA Section 23).

OTHER ACTION:	As part of AICPA and NASBA's commitment to substantial equivalency, the organizations released a legal analysis supporting the authority of the state board to offer and rescind practice privileges under substantial equivalency without a license. The analysis was completed in order to assist states in enacting Section 23 of the UAA.
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TORT REFORM

UAA 1. PRIVITY OF CONTRACT

ISSUE: Whether states should limit the extent of certified public accountants' liability to third parties for negligence.

BACKGROUND: Two parties who have a direct contractual relationship, such as a CPA and a client, are said to be in privity. As a result of this relationship, the client has the right to bring a lawsuit for negligent or fraudulent actions. Although injured third parties may sue an accountant for fraudulent conduct, how far an accountant's liability for negligence should extend to third parties is often in question.

WHY IT'S IMPORTANT TO CPAs: The privity issue is extremely important to CPAs since the number of third parties who may ultimately utilize an accountant's work is exponentially greater than the number of clients. Case law or legislation that renders CPAs liable for negligence to large numbers of these third persons has dramatically increased the number of suits and the potential liability of CPAs. The growing burden of liability threatens the ability of CPAs to fully serve the public's need for objective and reliable financial information.

AICPA POSITION: The AICPA favors limitations on the extent of CPAs' third party liability and recommends the following elements in legislation:

1) The accountant must have known, at the time the engagement was undertaken, that the financial statements were intended for use by the plaintiff who was specifically identified to the defendant;

2) The accountant must have known that the plaintiff intended to rely upon the financial statements in connection with the specified transaction; and

3) The accountant had direct contact and communication with the plaintiff and expressed by word or conduct the defendant accountant's understanding of the reliance on such financial statements or other information.

In addition, the AICPA/NASBA *Uniform Accountancy Act* (UAA) contains a privity provision. For more information on this section consult Section 20 of the Act.

STATE ACTION: Arkansas, Guam, Illinois, Kansas, Louisiana, New Jersey, Utah and Wyoming have enacted privity standards within their accountancy statutes. In addition, several state courts have handed down favorable decisions.

OTHER ACTION: AICPA staff actively assists state CPA societies by providing information on developments in tort reform and assistance in crafting favorable legislation. Also, the *AICPA Legal Liability Resource Library*, which contains the *Tort Reform Handbook* and other information regarding liability reform efforts, is available to state societies and interested parties.

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UAA 2. PROPORTIONATE LIABILITY

ISSUE: Whether joint and several liability provisions for accountants should be abolished and replaced with state rules that provide for proportionate liability.

BACKGROUND: Accountants are increasingly finding themselves the subject of civil litigation involving multiple parties. Under joint and several liability, multiple defendants found to be liable share in the burden of paying damages to the plaintiff without regard to the proportion of damage caused by any one defendant.

WHY IT'S IMPORTANT TO CPAs: By abolishing joint and several liability and replacing it with proportionate liability, defendants will be liable to pay only that portion of the damages for which they are directly responsible. This will eliminate the specter of one or two defendants, who may have been minimally at fault, being required to pay entire damage awards.

AICPA POSITION: The AICPA believes that each defendant should be severally liable and should not be compelled to pay more than each defendant's own proportionate share of the plaintiff's loss. The AICPA has actively promoted statutes that eliminate or modify joint and several liability.

In addition, the AICPA/NASBA *Uniform Accountancy Act* (UAA) contains a proportionate liability provision. For more information on this provision, consult Section 22 of the Act.

STATE ACTION: Nineteen states have abolished joint and several liability. Twenty-two states have modified joint and several liability and several other state courts have handed down favorable decisions. **In 2005, Georgia recently passed legislation reforming their joint and several, whereas, Florida has introduced legislation.** Iowa and Mississippi attempted to reform Joint and Several Liability in 2004. While in 2003, Minnesota enacted legislation requiring defendants to pay damages only for their percentage of fault.

OTHER ACTION: AICPA staff actively assists state CPA societies by providing information on developments in tort reform and in crafting favorable legislation. Also, the *AICPA Legal Liability Resource Library,* which contains the *Tort Reform Handbook* and other information regarding liability reform efforts, is available to state societies and interested parties.

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UAA 3. UNIFORM STATUTE OF LIMITATIONS

ISSUE: Whether a uniform statute of limitations should be established for suits involving negligent performance of accounting services and breach of contract actions.

BACKGROUND: The statute of limitations for breach of contract and negligent performance of accounting services vary from state to state. Accountants face uncertainty over potential liability exposure under these different state limitation periods.

WHY IT'S IMPORTANT TO CPAs: A uniform statute of limitations would reduce the uncertainty over potential liability under the different state limitation periods.

AICPA POSITION: The AICPA supports enactment of a uniform statute of limitations for an accountant's negligence and breach of contract actions. The AICPA developed language envisioning a limitation of one year from the date the alleged act or omission is discovered or should have been discovered in the exercise of reasonable diligence, or three years after the service for which the suit is brought has been performed or the date of the initial issuance of the accountant's report on the financial statements or other information, whichever comes first.

In addition, the AICPA/NASBA *Uniform Accountancy Act* (UAA) contains a statute of limitations provision. For more information on this provision consult Section 21 of the Act.

STATE ACTION: No significant activity occurred in 2002. However, the issue will continue to be monitored.

OTHER ACTION: AICPA staff actively assists state CPA societies by providing information on developments in tort reform and assistance in crafting favorable legislation. Also, the *AICPA Legal Liability Resource Library*, which contains the *Tort Reform Handbook* and other information regarding liability reform efforts, is available to state societies and interested parties.

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4. PUNITIVE DAMAGES

ISSUE: Whether punitive damage awards should be limited in suits involving civil actions against CPAs.

BACKGROUND: Punitive damage awards are an increasingly visible phenomenon in contemporary litigation. Both the number and size of such awards have increased markedly in the past several years. These awards have been justified under the same rationale that is used in the criminal justice system in imposing penal sanctions - to punish a defendant who has engaged in reprehensible conduct and to deter the defendant and other persons from engaging in such conduct in the future. By definition, punitive damage awards are not intended to compensate the injured party. Unfortunately, actual punitive damage awards often bear no relation to deterrence. Furthermore, despite the close analogy to criminal sanctions, punitive damages have been awarded without the procedural safeguards and heightened burden of proof that apply in the criminal context.

WHY IT'S IMPORTANT TO CPAs: Excessive punitive damage awards based on the actions of their employees especially threaten accounting firms. An individual, often discrete, error of one accounting professional may subject the firm to the threat of vicarious punitive liability for conduct in which the firm, as an institution, has neither participated nor condoned. Moreover, accounting firms are often the only "deep pockets" left after a company, for which it performed an audit, suffers financial losses. As a result, accounting firms are frequently looked to for damages that far exceed the extent of their responsibility for the loss suffered.

AICPA POSITION: The AICPA supports all legislative reforms to rectify the present imbalance that exists in our legal system regarding the awarding of punitive damages. Specifically, the AICPA supports language that includes procedural safeguards and requires a jury to determine the percentage of a particular defendant's responsibility for the compensatory awards. A limit or "cap" is then placed on the punitive damage award based on the amount of compensatory damages for which a defendant is responsible. The punitive damages award is then limited by this determination.

OTHER ACTION: AICPA staff actively assists state CPA societies by providing information on developments in tort reform and assistance in crafting favorable legislation. Also, the *AICPA Legal Liability Resource Library*, which contains the *Tort Reform Handbook* and other information regarding liability reform efforts, is available to state societies and interested parties.

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5. ALTERNATIVE DISPUTE RESOLUTION

ISSUE: Whether alternative dispute resolution (ADR) should be used by CPAs as a method of resolving disputes with clients.

BACKGROUND: Alternative dispute resolution is a term used to describe a variety of techniques for resolving conflicts without taking legal action. Within the past few years, the use of these techniques as a method of resolving business disputes has gained momentum.

A number of professions have supported ADR programs and, by doing so, have provided significant benefit to their members. Many state bar associations have developed arbitration programs to handle disputes between members and their clients over fees. Professionals such as engineers and architects, and members of the financial services industry, including banks and stockbrokers, frequently use ADR techniques.

There are various methods of resolving disputes outside of court that are collectively assembled under the ADR umbrella. These techniques include *negotiation*, *mediation* and *arbitration*. The main distinction among the categories is the amount of control the disputing parties have over the process and the outcome.

WHY IT'S IMPORTANT TO CPAs: ADR provides a way to save time and money, protect confidentiality, avoid setting legal precedents and, hopefully, preserve a business relationship. In addition, studies have indicated that almost 50 percent of practitioners do not carry malpractice insurance. For these CPAs, ADR can provide a great benefit.

AICPA POSITION: The AICPA encourages state societies to implement ADR programs to help mitigate current liability costs. State organizations are the best suited for sponsoring member education of ADR, for identifying ADR service providers in the state and for helping to identify or develop a panel of neutral individuals to serve as mediators or arbitrators in the ADR process. An implementation plan for ADR should include: 1) identifying the current environment for use of ADR by professionals; 2) eliminating barriers to use ADR; and, 3) identifying or developing tools and resources for use of ADR.

STATE ACTION: The following states have adopted arbitration statutes to enforce agreements to arbitrate existing controversies that may arise in the future. (NOTE: Those states indicated below signify that the Uniform Arbitration Act has been adopted in entirety or with modifications. Those states underlined denote state statutes that are relevant to construction disputes only).

Alaska, Arizona, California, Colorado, Connecticut, Delaware, District of Columbia, Florida, <u>Georgia</u>, Hawaii, Idaho, Illinois, Indiana, Iowa, Kansas, Kentucky, Louisiana, Maine, Maryland, Massachusetts, Michigan, Minnesota, <u>Mississippi</u>, Missouri, Montana, Nebraska, New Hampshire, New Jersey, New Mexico, New York, North Carolina, North Dakota, Ohio, Oklahoma, Oregon, Pennsylvania, Puerto Rico, Rhode Island, South Carolina, South Dakota, Tennessee, Texas, Utah, Vermont, Virginia, Washington, Wisconsin and Wyoming.

In addition, Alabama and West Virginia have adopted statutes that apply only to existing controversies.

OTHER ACTION: The publication *Alternative Dispute Resolution: A Guide for State Societies* has been distributed by the AICPA's Accountants' Legal Liability Committee. This document serves as a handbook for evaluating the ADR environment in the states, and implementing ADR techniques. In addition, the *Legal Liability Resource Library*, which contains the *Tort Reform Handbook* and other information regarding liability reform efforts, is available to state CPA societies and interested parties.

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